

## Message Text

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ACTION ARA-10

INFO OCT-01 ISO-00 SP-02 AID-05 EB-04 NSC-05 RSC-01

CIEP-01 TRSE-00 SS-15 STR-01 OMB-01 CEA-01 CIAE-00

COME-00 FRB-01 INR-05 NSAE-00 XMB-02 OPIC-03 LAB-01

SIL-01 AGR-05 DODE-00 PA-01 USIA-06 PRS-01 /073 W

----- 083016

R 011430Z NOV 74

FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC 6244

INFO AMCONSUL RIO DE JANEIRO

AMCONSUL SAO PAULO

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PASS TREASURY

E.O.11652: N/A

TAGS: EFIN, BR, EGEN

SUBJECT: CONSUMER CREDIT EASED WHILE CRUZEIRO DEVALUED AGAIN

REF: (A) BRASILIA 8159 (B) BRASILIA 3419

1. SUMMARY: FOLLOWING THE WAGE AND TAX CHANGES ANNOUNCED OCTOBER 24 (REFTEL A), THE NATIONAL MONETARY COUNCIL HAS APPROVED A NUMBER OF MEASURES DESIGNED TO STIMULATE AGGREGATE DEMAND BY EXPANDING CONSUMER CREDIT. IN ADDITION, THE CENTRAL BANK HAS ANNOUNCED ANOTHER DEVALUTATION OF THE CRUZEIRO, THE NINTH THIS YEAR, FOR 1.26 PERCENT, BRINGING THE CUMULATIVE DEVALUATION IN 1974 TO 16.18 PERCENT.

2. THE LATEST MEASURES ON WAGES, TAX AND CREDIT FRONTS SIGNAL A LOOSING UP IN GOB'S ANTI-INFLATIONARY POLICIES, SOME OF WHICH, SUCH AS THE TIGHT CREDIT MEASURES, HAD BEEN IN EFFECT ONLY FOR FEW MONTHS (REFTEL B) PRIMARILY AS A RESULT OF POLITICAL PRESSURES EMANATING FROM THE COMING CONGRESIIONAL ELECTIONS.

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THE GOB HAS APPARENTLY OPTED FOR MORE EXPANSIONARY POLICIES NOW,

BEFORE THERE WERE CLEAR INDICATIONS THAT INFLATION WAS UNDER CONTROL AND AT A TIME WHEN THE BALANCE OF PAYMENTS IS IN DIFFICULTIES. THE KEY QUESTION RAISED BY THIS SHIFT IN POLICY IS WHETHER THE GOVERNMENT MOVED PREMATURELY TO MEET SOME SHORT TERM NEEDS WHILE JEOPARDIZING THE LONGER-TERM STABILITY OF THE ECONOMY. THIS MOVE ALSO SEEMS TO BE INCONSISTENT WITH, IF NOT A REVERSAL OF, FINANCE MINISTER SIMONSEN'S OFTEN REPEATED POSITION THAT A RAPID GROWTH RATE WOULD BE PURSUED AS LONG AS THE BALANCE OF PAYMENTS PERMITTED. THESE MEASURES ARE LIKELY TO INCREASE THE CURRENT ACCOUNT DEFICIT DURING 1975 BEYOND WHAT IT WOULD OTHERWISE HAVE BEEN. GIVEN THE UNCERTAIN INTERNATIONAL MONETARY SITUATION, BRAZIL IS NOT ASSURED OF FINDING THE REQUISITE OUTSIDE FINANCING TO CLOSE ITS EXTERNAL GAP NEXT YEAR. AUTHORITIES, THEREFORE, MAY BE SETTING THE STAGE FOR AN EVEN TOUGHER YEAR NEXT YEAR. END SUMMARY

3. FOLLOWING THE WAGE AND TAX MEASURES ANNOUNCED OCTOBER 24 (REFTEL A), THE NATIONAL MONETARY COUNCIL HAS EASED THE AVAILABILITY OF CONSUMER CREDIT IN ORDER TO STIMULATE DEMAND FOR CONSUMER DURABLES WHICH HAD WEAKENED SOMEWHAT RECENTLY. THE OBJECTIVE OF THESE MEASURES IS TO INCREASE THE SUPPLY OF CREDIT FOR INSTALLMENT BUYING FOR PERIODS BEYOND 24 MONTHS, THE PREVIOUSLY DE-FACTO CEILING ON INSTALLMENT CREDITS SET BY THE COUNCIL IN MAY 1974 (SEE REF B),

4. THE EASING OF CONSUMER CREDIT IS BEING EFFECTED BY CHANGING THE RULES ON THE APPLICATION OF MONETARY CORRECTION TO BILLS OF ACCEPTANCE. WHEREAS PREVIOUSLY PRE-FIXED MONETARY CORRECTIONS COULD BE APPLIED ONLY TO BILLS OF ACCEPTANCE WITH A MATURITY OF UP TO 24 MONTHS WHILE THOSE WITH MATURITY OF OVER 24 MONTHS HAD TO CARRY POST-FIXED MONETARY CORRECTION, UNDER THE NEW GUIDELINES FINANCIAL INSTITUTIONS CAN ISSUE BILLS OF ACCEPTANCE WITH A MATURITY LONGER THAN 24 MONTHS WITH A COMBINATION OF PRE-FIXED (PRESUMABLY FOR THE FIRST 24 MONTHS) AND POST-FIXED (AFTER THE 24TH MONTH) MONETARY CORRECTION. UNDER THE PREVIOUS REGIME, THE REQUIREMENT THAT BILLS OF ACCEPTANCE CARRY POST-FIXED MONETARY CORRECTION FOR PERIODS OVER 24 MONTHS HAD EFFECTIVELY RULED THEM OUT AS A SOURCE OF FINANCING FOR LONG-TERM CONSUMER CREDIT (OVER 24 MONTHS) GIVEN THE ELEMENT OF UNCERTAINTY WITH RESPECT TO THE LIMITED OFFICIAL USE

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EXACT INTEREST RATE TO BE PAID BY SUCH AN ASSET.

5. THE MONETARY COUNCIL HAS, IN ADDITION, ADJUSTED THE TAX ON FINANCIAL TRANSACTIONS TO PROVIDE A DISINCENTIVE FOR EXCESSIVE USE OF BILLS OF ACCEPTANCE OVER 24 MONTHS. IT ALSO INCREASED THE MAXIMUM AMOUNT OF PERSONAL LOANS FROM 10 TO 20 TIMES THE MINIMUM SALARY (TO ABOUT US\$1,500).

6. THE CENTRAL BANK DEVALUED, EFFECTIVE OCTOBER 28, THE CRUZEIRO BY 1.26 PERCENT, THE NINTH SUCH CHANGE THIS YEAR, BRINGING THE CUMULATE DEVALUATION IN 1974 TO 16.18 PERCENT. NEW CRUZEIRO/DOLLAR RATES ARE 7.18 FOR BUY AND 7/22 FOR SELL.

7 CONGEN SAO PAULO REPORTS THAT BUSINESS AND BANKING SOURCES APPROACHED LAST WEEK WERE HESITANT IN EXPRESSING REACTION TO THE RECENT GOB WAGE, TAX, AND MONETARY MEASURES SINCE THEY FEEL THAT A NUMBER OF IMPONDERABLES MAY AFFECT THE ECONOMY ONE WAY OR ANOTHER. MOST AGREE, HOWEVER, THAT THE RATE OF INFLATION THIS YEAR WILL PROBABLY HIT 35 PERCENT IN SAO PAULO (12 MONTH FIGURES SEPT. 1973-1974 INDICATED A RISE IN THE COST-OF-LIVING IN THE CITY OF SAO PAULO OF THE ORDER OF 3-.59 CPERCENT). OTHERS ARE CONCERNED ABOUT THE MONETARY SITUATION, THE DEALY ON THE PART OF THE ADMINISTRATION IN INTRODUCING MEASURES TO OFF-SET TO SOME EXTENT AN EXTREMELY TIGHT MONEY SITUATION AND A LIBERAL WAGE POLICY WHICH CAN ONLY AFFECT UNFAVORABLY THE FIGHTAGAINST INFLATION. THEY DO AGREE HOWEVER, THAT THE INCREASES IN WAGES SHOULD GIVE SOME SUPPORT TO CONSUMER BUYING DURING THE CHRISTMAS SEASON. THEY DOUBT, HOWEVER, THAT VOLUME OF SALES WILL EXCEED SUBSTANTIALLY THE LEVELS OF SALES DURING THE 1973 SEASON.

8. SOME MEMBERS OF SAO PAULO BUSINESS COMMUNITY FEEL THAT WAGE INCREASES WILL NOT SUBSTANTIALLY AFFECT OPERATING COSTS OF LARGE MANUFACTURERS IN SAO PAULO AREA, SINCE INMOST CASES THESE COMPANIES HAVE FOLLOWED THE POLICY OF GRANTING PARTIAL INCREASES IN SALARIES AT LEAST TWO TO THREE TIMES IN THE COUSE OF THE YEAR IN ANTICIPATION OF THE "DISSIDIO COLETIVO" AGREEMENT. IN MOST CASES LABOR UNIONS IN THE SAO PAULO AREA HAVE BEEN GRANTED, EFFECTIVE EITHER SEPTEMBER OR OCTOBER LIMITED OFFICIAL USE

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THIS YEAR, INCREASES AVERAGING A LOW OF 28 PERCENT AND A HIGH OF 35 PERCENT. INCREASES IN OPERATING COSTS RESULTING FROM AUTHORIZED ANNUAL WAGE INCREASES ARE INCLUDED IN REQUESTS FOR PRICE INCREASES SUBMITTED BY MANUFACTURERS TO GOB PRICE COUNCIL.

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ACTION ARA-10

INFO OCT-01 ISO-00 SP-02 AID-05 EB-04 NSC-05 RSC-01

CIEP-01 TRSE-00 SS-15 STR-01 OMB-01 CEA-01 CIAE-00

COME-00 FRB-01 INR-05 NSAE-00 XMB-02 OPIC-03 LAB-01

SIL-01 AGR-05 DODE-00 PA-01 USIA-06 PRS-01 /073 W

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R 011430Z NOV 74

FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC 6245

INFO AMCONSUL RIO DE JANEIRO

AMCONSUL SAO PAULO

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PASS TREASURY

9. COMMENT: THESE LATEST ACTIONS SIGNAL A RELAXATION IN THE GOB'S EFFORTS TO CONTAIN INFLATION IN FAVOR OF A MORE STIMULATIVE MONETARY AND FISCAL POLICY DESIGNED TO ASSURE THE MAINTENANCE OF A HIGH GROWTH RATE. SUCH A POLICY SHIFT, COMING AT A TIME WHEN THE BALANCE OF PAYMENTS DEFICIT IS BOTH WIDENING AND MORE DIFFICULT TO FINANCE WITH OUTSIDE SOURCES OF FINANCING, RAISES THE QUESTION AS TO WHETHER THE NEW MEASURES WERE PREMATURE. SEVERAL ACADEMIC ECONOMISTS CONTACTED THIS WEEK THOUGHT THAT THEY WERE. ON THE INFLATION FRONT, DESPITE A DECREASE IN THE REAL MONEY SUPPLY OF ABOUT 14 PERCENT THROUGH MID-OCTOBER, INFLATION NEVERTHELESS IS CURRENTLY RUNNING AT AN ANNUAL RATE OF ABOUT 24 PERCENT. WITH RESPECT TO THE BALANCE OF PAYMENTS THE CURRENT ACCOUNT DEFICIT IN 1974 IS BEING ESTIMATED AT \$7 BILLION AS COMPARED WITH \$1.3 BILLION FROM LAST YEAR (SEE BRASILIA 7805). WE CAN EXPECT, AS A RESULT OF THESE ACTIONS, THAT THE CURRENT ACCOUNT DEFICIT IN 1975 WILL BE ABOVE WHAT IT WOULD OTHERWISE HAVE BEEN. CENTRAL BANK OFFICIALS HAVE MENTIONED TO US A TRADE DEFICIT TARGET OF \$3 MILLION FOR 1975 (COMPARED TO \$4.5-5 BILLION THIS YEAR),

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BASED ON STRONG EFFORTS TO HOLD DOWN THE RISE IN IMPORTS.

10. GIVEN THE UNCERTAIN INTERNATIONAL MONETARY SITUATION, BRAZIL IS NOT ASSURED OF RECEIVING SUFFICIENT OUTSIDE CAPITAL

IN 1975 TO FINANCE A LARGE PAYMENTS DEFICIT. CONSEQUENTLY, BY TRYING TO MAINTAIN THE ECONOMY ON A HIGH GROWTH PATH, AUTHORITIES MAY BE SETTING THE STAGE FOR A TOUGHER YEAR NEXT YEAR THAN ORIGINALLY ANTICIPATED. THIS POLICY OF MAINTAINING A HIGH GROWTH RATE AT A TIME WHEN THE CURRENT ACCOUNT DEFICIT HAS BECOME DIFFICULT TO FINANCE IS INCONSISTENT WITH, IF NOT A REVERSAL OF FINANCE MINISTER SIMONSEN'S OFT-REPEATED STATEMENT THAT A RAPID GROWTH RATE WOULD BE MAINTAINED AS LONG AS THE BALANCE OF PAYMENTS PERMITTED. THE FACT THAT BRAZIL WILL PROBABLY NEED TO DRAW DOWN ITS RESERVES BY \$1 TO \$2 BILLION THIS YEAR WOULD SEEM TO INDICATE THAT THE BALANCE OF PAYMENTS HAS BECOME A CONSTRAINT TO A CONTINUED ACCELERATED GROWTH RATE. THE GOVERNMENT HAS ALREADY ESTABLISHED A COMMISSION TO CLOSELY MONITOR IMPORTS BY STATE ENTERPRISES AND FURTHER DETERIORATION OF THE BALANCE OF PAYMENTS MAY BRING ABOUT SOME TRADE RESTRICTIONS NEXT YEAR.

10. BEFORE THESE EASING MEASURES WERE INTRODUCED THERE WERE SIGNS THAT THE CREDIT SQUEEZE PUT ON BY THE ADMINISTRATION SHORTLY AFTER IT CAME TO POWER IN MARCH 1974 WAS BEGINNING TO PINCH, ESPECIALLY IN THE CONSUMER DURABLES INDUSTRY IN GENERAL AND THE AUTOMOBILE SECTOR IN PARTICULAR. PERHAPS THE GOVERNMENT AS WELL AS INDUSTRY FELT THAT THE IMPACT WAS GREATER THAN DESIRABLE AND THAT REFLATION WAS DESIRABLE NOW. ALSO, LABOR WAS UPSET BECAUSE THE 21 PERCENT INCREASE IN THE MINIMUM WAGE APPROVED EARLIER THIS YEAR WENT ONLY PART WAY TO COMPENSATE IT FOR INFLATION, WHICH IS EXPECTED TO APPROACH 35 PERCENT FOR 1974. SOME EXPERTS BELIEVE THAT GOB SHOULD HAVE ADJUSTED DOMESTIC PRICE STRUCTURE PRIOR TO ANNOUNCING THE SPECIAL WAGE INCREASE, SINCE INEVITABLE PRICE RISES LATER ON MAY KINDLE FURTHER INFLATIONARY EXPECTATIONS AND UNDERMINE EFFORTS TO STABILIZE THE ECONOMY NEXT YEAR.

CRIMMINS

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## Message Attributes

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